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DEVELOPMENT AND INTERNATIONAL ECONOMIC COOPERATION

Impact of the recent evolution of the economies in transition on the world economy

Report of the Secretary-General

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BACKGROUND

The process of transition of the centrally planned economies of Eastern Europe and the former Union of Soviet Socialist Republics to the market economy that began in the late 1980s has major short- and long-term implications for international economic relations and for the growth of the world economy. In resolution 47/175 of 22 December 1992, the General Assembly requested the Secretary-General to prepare a report on several of these implications, such as those related to the impact of the transition on the growth of the world economy in general and developing countries in particular, international cooperation, and flow of resources to developing countries. The present report has been prepared in response to that request.

The secretariat earlier prepared two fairly detailed reports on the subject (E/1991/82 and A/47/403). The present report is partly an update of the earlier reports. As requested by the General Assembly in resolution 47/175, the secretariat will continue to review and analyse the various aspects of the impact of the transition in the East. This work is in fact an important part of the secretariat's regular monitoring and analysis of emerging trends in the world economy and is reported, among others, in the World Economic Survey, the Economic Bulletin for Europe and the Economic Survey of Europe.

Data problems constrain the quantitative analysis of some of the issues involved. This is particularly true of some trade data, while information on resource flows to the transition economies is still erratic. Some of the conclusions of the present report are therefore necessarily tentative.

I. FROM CENTRAL PLANNING AND AUTARKY TO PRICE MECHANISM AND OPENNESS

1. For decades, the countries of Eastern Europe and the former Union of Soviet Socialist Republics largely followed a policy of autonomy from the rest of the world economy, forging instead close economic links among themselves and cultivating ties with a select group of developing countries. Economic integration among these countries made considerable headway, mainly through the Council for Mutual Economic Assistance (CMEA). On the eve of the political changes about 50 per cent of the external trade of these countries was accounted for by trade among themselves, and their production structures had become closely interdependent. By and large, these countries had only minimal contact with international financial and trade institutions and, except for Czechoslovakia, Hungary, Poland, Romania and Yugoslavia, they remained outside the International Monetary Fund (IMF), the World Bank and the General Agreement on Tariffs and Trade (GATT). Their role in international cooperation was marked by divisions and dissensions between them and the industrialized countries, largely along ideological lines. In international finance their role was even more limited than in trade and became increasingly so with the rapid growth and globalization of financial markets. Nevertheless, these countries accumulated significant amounts of foreign debt owed to industrialized countries, while there was a large build-up of debt owed to them, especially to the former Soviet Union, by developing countries.

2. The domestic economy, especially as it became more complex, began to reveal the inadequacies of central planning. Lacking market signals, production and distribution decisions such economies became increasingly difficult and inefficient. The incentive to increase productivity was weak. Technologies used in production were falling far behind those available in the West. As productivity stagnated and the growth of population tapered off, the growth of aggregate output slowed. The quest for increased output in the absence of growth of productivity led to a more intense use of existing resources, especially natural resources, thereby contributing to a far greater environmental depletion and degradation than thought possible under central planning. By the second half of the 1980s, these economies appeared trapped at a relatively "low" level of economic development, with inefficient technologies, a large but outmoded capital stock which needed replacement, increasing costs in the exploitation of natural resources, inadequate institutional means to mobilize domestic resources for development, and a seriously degraded environment.

3. The sharp reorientation of economic policy in these countries that followed the dramatic change in their political regimes involved the introduction of an economic system in which allocation of resources is carried out mainly by price mechanism rather than by central planning, and the opening of the domestic economy to the opportunities and challenges of the rest of the world economy, itself driven largely, though by no means entirely, by market forces. The transition has turned out to be an extremely difficult process. The market mechanism could not be instantly introduced in all spheres of the economy and the links of the domestic economy to the external world could only be gradually established. While the reorientation of policies promised substantial long-term benefits to the world economy as well as to the economies in transition, it

involved some short- to medium-term costs to the domestic economy as well as to the rest of the world. Large changes of this nature inevitably affect existing trade links, call for new trade relationships, and generate new financial flows among countries, potentially affecting some of the existing flows. Some of these developments may well be influenced by international political perceptions of the relative needs of different country groups and opportunities that they may seem to offer. Whatever the cause, they affect the command on world resources and the pattern of their use, influencing world economic growth and the economic circumstances of individual countries in various degrees, and change the nature and scope of international economic cooperation.

A. The short-term impact on the global economy

4. The process of transition in Eastern Europe and the former Soviet Union has been accompanied by a sharp fall in output. Over the period 1989-1992, the fall was probably of the order of 30. The growth of the world economy itself came to a virtual standstill at the same time, but this was largely due to the slowdown and recession in the industrialized economies that practically coincided with the beginning of the changes in the East. The contribution of the economies in transition to the slowdown in the global economy has been small.

5. The economies of the former Soviet Union and Eastern Europe account for only a small proportion of world output and trade. Estimation of the value of output in these economies for international comparison has always been difficult. Some estimates put the total output in these economies in 1988, that is, just before the beginning of the political changes in the area, at around 13 per cent of world output. 1/ More important, because of their autarkic nature, these economies accounted for an even smaller proportion of world trade than of world output. In 1988, only about 6 of world exports originated in these countries. Of this, about 50 per cent was destined for countries within the group. In other words, their trade with the developed market economies and developing countries accounted for only about 3 per cent of world trade, almost equally divided between the two groups.

6. With such a small weight in world trade, even the very large fall in the volume of trade of these economies (probably as much as 25 per cent in the period 1990-1992) has left the growth of world trade, especially trade outside these economies, virtually unaffected. The total direct effect on the growth of the world economy has been very small.

B. Implications for international cooperation

7. One of the first steps that most countries in Eastern Europe and the former Soviet Union took was to seek membership in multilateral financial and development institutions and to associate themselves more closely with western regional economic groupings. Almost all of these countries are now members of IMF and the World Bank. The Czech Republic, Hungary, Poland, Romania and Slovakia are already contracting parties to GATT and most other countries have applied for observer status, while several are in the process of negotiation for membership. Bulgaria, the former Czechoslovakia, Hungary, Poland and Romania entered into association agreements with the European Community as a potential

entered into association agreements with the European Community as a potential first step to integration with the latter; the Czech Republic and Slovakia are expected to succeed to the agreements signed by the former Czechoslovakia. All in all, the great cold war alienation between East and West has been replaced by a keenly felt desire by the countries in the East for cooperation and forging of economic links. This does not by any means ensure a frictionless economic relationship among countries. Resolution of conflicts of interest among countries and groups of countries will remain the grist of international cooperation. But the changes in the East are a major step towards a better environment in which that cooperation can be strengthened.

II. THE EVOLUTION OF TRADE RELATIONSHIPS OF THE ECONOMIES IN TRANSITION

8. The most visible impact of the transition in Europe has been in the shifting trade relations of these economies. 2/ The sharp fall in output in Eastern Europe and the former Soviet Union has been accompanied by an equally sharp decline in these countries' external trade. The change in the direction of trade has been dramatic.

9. In Eastern Europe, the United States dollar value of total exports declined by about one third, while imports declined by about a fifth over the period 1989-1992 (table 1). The fall in the value of intra-CMEA trade was far sharper. As the CMEA collapsed, trade among former members of the group themselves as well as with the former Soviet Union, declined by about three quarters. However, trade with the developed market economies continued to grow. Over the period 1989-1992, the value of these countries' exports to the developed market economies rose by some 35 per cent, 3/ while the value of imports from these economies increased by about 70 per cent. The share of the developed market economies in these countries' external trade rose from around 30 per cent in 1989 to 60 per cent in 1992. These trends suggest a quickly growing link of these economies with the developed market economies. Proximity to Western Europe, the early start of the transition process, compared with the former Soviet Union, and association agreements of some of these countries with the European Community, contributed to the growth of this trade.

10. Eastern Europe's trade with developing countries, on the other hand, suffered a large decline. The value of exports fell some 35 per cent over the period 1989-1991 but recovered in 1992, with an increase of around 20 per cent. Imports from these countries declined by almost 40 per cent during 1989-1992, with the sharpest decline in 1991.

11. The total value of trade of the Soviet Union and its successor States declined by over 40 per cent between 1989 and 1992. As with Eastern Europe, the change was the sharpest in intra-CMEA trade. Exports to Eastern Europe declined by some 60 per cent over 1989-1992, while imports collapsed and in 1992 were only 25 per cent of their level of 1989. Unlike the countries of Eastern Europe, however, trade with the developed market economies also declined. Exports to these economies fell by some 30 per cent over 1991-1992, as did imports from these sources.

Table 1. Eastern Europe and the former Soviet Union: value and growth of trade, 1989-1992
(Billions of dollars and percentages)

Country	Exports				Imports			
	Value	Change (per cent)			Value	Change (per cent)		
	1989	1990	1991	1992	1989	1990	1991	1992
Eastern Europe								
Total	63.7	-12.9	-20.7	-0.9	58.1	-7.1	-14.3	5.8
Eastern Europe	11.1	-36.0	-52.1	-11.8	11.3	-21.2	-66.3	-10.0
(Former) Soviet Union	22.5	-24.9	-53.3	-30.4	19.0	-18.4	-38.7	-7.4
Developed countries	20.2	13.4	15.3	4.2	18.4	9.8	33.7	17.0
Developing countries	9.9	-13.1	-26.7	20.6	9.4	0.0	-27.7	-13.2
(Former) Soviet Union[a]								
Total	62.2	-5.0	-21.0	-25.1	64.9	0.2	-30.2	-21.3
Eastern Europe	14.1	-21.3	-17.1	-37.4	16.8	-10.7	-41.3	-49.5
Developed countries	25.6	14.1	-9.6	-21.8	32.5	5.8	-23.3	-12.5
Developing countries	22.5	-16.4	-41.0	-20.8	15.6	0.0	-34.6	-10.3
Eastern Europe and (former) Soviet Union[a]								
Total	125.9	-9.0	-20.9	-13.9	123.0	-3.3	-22.9	-7.5
Eastern Europe	25.2	-27.8	-30.8	-31.5	28.1	-14.9	-50.6	-41.1
Developed countries	45.8	13.8	1.3	-9.5	50.9	7.3	-2.2	2.7
Developing countries	32.4	-15.4	-36.5	-4.9	25.0	0.0	-32.0	-11.6

Source: All data are drawn from the common database kept at the Economic Commission for Europe (ECE) which is based on national statistical publications, direct communications to the ECE secretariat from national statistical offices and (for 1992) in part on trade partner data. Both export and import values are expressed f.o.b., except for Hungarian imports which are shown c.i.f. in the national returns. Growth rates are calculated on values expressed in United States dollars. Trade with the East, including most of trade with eastern Europe and the former Soviet Union, in the years prior to 1991 was valued in an adjusted dollar measure reflecting consistent rouble/dollar cross-rates. All trade values for 1991 and 1992 were converted to dollars at the appropriate national conversion coefficient (usually the commercial rate quoted by national banks). The partner country grouping follows the practice until recently prevalent in the national statistical sources, which differs from the breakdown usually employed in United Nations publications.

[a] In the absence of data for other states of the former Soviet Union, the percentage changes in 1992 relate to the Russian Federation alone. Russia accounted for over 80 per cent of the total trade of the former Soviet Union. Data for Russia in 1992 are Secretariat estimates based on partial official data. For source, see: Russian Economic Monitor (Moscow), vol. 2, No. 3, March 1993, p. 7.

12. The fall in trade of the former Soviet Union with the developing countries was even sharper than for Eastern Europe. Exports to developing countries declined by 60 per cent, while imports from them fell by some 40 per cent. As discussed below, much of this sharp fall was in trade with countries that had earlier had special relationships with the Soviet Union.

13. Exports of the economies in transition as a whole declined by some 40 per cent during 1989-1992, while their imports fell by about 30 per cent. Trade with developed countries increased only marginally. Their exports to developing countries plummeted, falling by about 50 per cent, while their imports from these countries fell by about 40 per cent. 4/

Impact on trade of developing countries

14. The value of imports of the economies in transition from the developing countries amounted to around $25 billion in 1989. This was around 4 per cent of the total exports of the developing countries. Exports from the transition economies amounted to $32 billion or also around 4 per cent of the total imports of developing countries. These are relatively small magnitudes and even the sharp drop in this trade that has taken place in recent years, as indicated above, was not expected to have a significant impact on the growth of their total trade. The $30 billion or so decline in trade with the economies in transition between 1989 and 1992 was only about 2 per cent of the total trade of the developing countries in 1989. During this period, the dollar value of trade of these countries increased by about 35 per cent. With no change in the value of trade with the transition economies, the growth of trade would probably have been about two percentage points higher.

15. The impact, however, varied greatly among countries, depending on the nature and closeness of the link between these countries with the economies in transition as well as the ability of the individual developing countries to respond to changing circumstances.

16. Three developing countries - Cuba, Mongolia and Viet Nam - were members of CMEA. With the collapse of the institution, their trade with the East was seriously disrupted. The bulk of this trade was with the Soviet Union. In 1989 the total exports of those three countries to the economies in transition amounted to around $4.0 billion of which $3.0 billion went to the Soviet Union (table 2). By 1992 the total had dwindled to around $1.3 billion, a drop of two thirds. Similarly, imports of these countries from the transition economies declined from $4.5 billion in 1988 to $0.8 billion, which was an even sharper fall of over 80 per cent. By any measure, such a decline in both exports and imports represented a major shock to these developing countries. By far the most important factor behind the fall of trade between the developing countries in the aggregate and Eastern Europe and the former Soviet Union is the collapse of trade of this group.

17. A second group of developing countries that was adversely affected was the CMEA "cooperants" (table 2) whose export revenues to the economies in transition declined by some 35 per cent over the period 1989-1991 but increased by about 10 per cent in 1992. Their imports declined by about 5 per cent in 1990-1991, but recovered in 1992.

Table 2. Eastern Europe and the former Soviet Union: trade with selected groups of developing countries, 1990-1992
(Millions of dollars and percentages)

Country	Exports				Imports			
	Value 1989	Change (per cent) 1990	1991	1992	Value 1989	Change (per cent) 1990	1991	1992
Eastern Europe								
CMEA (3)	619.0	-31.8	-79.6	10.3	940.4	-45.4	-75.8	12.1
Cooperants	462.3	-34.7	-61.7	10.2	627.4	-7.7	-91.5	37.6
Others	2064.3	-25.0	-2.0	9.3	4395.3	-16.6	-23.8	8.0
NIEs	1327.6	-2.8	14.6	19.2	1592.5	-10.0	177.2	-2.9
(Former) Soviet Union								
CMEA (3)	3924.7	-6.4	-60.4	-51.8	3013.7	63.7	-51.7	-51.8
Cooperants	1077.5	14.0	9.7	10.0	664.8	7.9	10.0	10.0
Others	1789.4	15.9	2.9	7.1	4254.3	23.4	-17.1	9.1
NIEs	1034.6	63.5	25.8	2.2	2017.0	-19.8	25.1	6.0
Eastern Europe and (former) Soviet Union								
CMEA (3)	4543.7	-9.9	-62.4	-48.4	3954.0	37.8	-54.0	-48.6
Cooperants	1539.8	-0.6	-4.4	10.0	1292.2	0.3	-35.3	11.6
Others	3853.7	-6.0	0.8	8.0	8649.6	3.0	-19.9	8.7
NIEs	2362.2	26.3	20.9	9.2	3609.5	-15.5	96.6	0.1

Source: All data are drawn from the Direction of Trade Statistics (DOT), International Monetary Fund, Washington, D.C. For some reporters, notably Bulgaria and the "Former Soviet Union", only partial data for the groups, except the cooperant and collaborator countries, are available. Estimates for the three CMEA countries in the case of Bulgaria and the former Soviet Union have been made based on partial official data. The 1992 data refer to the Russian Federation alone.

Notes: CMEA (3) refers to Cuba, Mongolia and Viet Nam.

Cooperants are Afghanistan, Angola, Ethiopia, Iraq, Mexico, Mozambique, Nicaragua, and Democratic Yemen (now merged with Yemen; for 1990 data for Democratic Yemen and Yemen were aggregated).

Others with some special ties included in the data are: Algeria, Cambodia, Egypt, India, Iran (Islamic Republic of), Morocco, Pakistan and Syrian Arab Republic.

NIEs (newly industrialized economies) are Brazil, Hong Kong, Malaysia, Republic of Korea, Singapore, Taiwan Province of China, Thailand, Tunisia and Turkey.

18. There is a third group of countries that had no CMEA status but still had close ties with the East. Among them were a number of large countries, including India, with a substantial trade relationship with the former Soviet Union. Their exports to the economies in transition, which amounted to about $8.6 billion in 1989, dropped by about 20 per cent in 1990, but made a modest recovery in 1992, while their imports, valued at about $3.8 billion in 1989, increased slightly for the period as a whole.

19. In sharp contrast to these developments, a group of newly industrialized economies significantly increased their trade with Eastern Europe and the former Soviet Union. Exports of the group to the transition economies amounted to around $3.6 billion in 1989, which increased by almost 70 per cent to $6 billion in 1992, while imports from these economies rose from $2.4 billion to almost $4 billion.

20. Thus, while falling production, income and import demand in the economies in transition contributed to the fall in their trade with the developing countries, the breakdown of the special trade links, some of which followed the collapse of CMEA itself, was a major factor behind the phenomenon. The continuing growth of trade with countries without special links or only weak ties supports this conclusion. The higher rate of growth of exports of the newly industrialized economies over that of the developed market economies might suggest possibilities for other, and perhaps the more advanced, developing countries increasing their trade with the economies in transition when trade is not subject to special arrangements but is relatively free.

21. One of the indirect but immediate trade consequences of the transition in Europe has been felt in commodity prices, which are important for many developing countries. Strapped for hard currency, some of the countries in transition began to push their exports of raw materials, such as aluminium, copper and nickel, contributing to a further fall of their prices. At the same time, falling import demand resulting from sharply falling income tended to depress prices of some primary commodities, including tea, for which there was a significant market in Poland and the former Soviet Union, and industrial raw materials.

III. THE DIVERSITY OF EXPERIENCE OF DEVELOPING COUNTRIES

22. The impact of the changes in Eastern Europe and the Soviet Union on the developing countries varied greatly, as did the response to the changes, especially the ability of individual countries to switch to alternative channels of trade and sources of finance. Moreover, in many cases, long-drawn civil unrest or military conflicts, some of which can be traced to the ideological tension of the past between East and West, continued after the changes in the East, and these tended to obscure the effects of the transition per se. In a number of cases, a country's ties with the East were largely military so that their severance had little economic consequences except in special sectors.

23. Cuba, a developing country member of the former CMEA, stands out among countries that have been seriously affected by the changes in Europe. In 1989 about 85 per cent of the country's trade was with the Soviet Union and Eastern Europe. By 1992 this trade had declined to 10 per cent of its 1989 level.

External economic assistance from the East, closely related to trade, also plunged. In November 1992, however, a new trade agreement for 1993 doubled the planned sale of Cuban sugar to Russia and Russian oil exports to Cuba. Partly offsetting the decline of exports to Russia, exports to Canada increased. Western multilateral assistance to the country remained small (under $50 million a year). A largely undiversified economic structure, a virtual economic blockade by the United States and the absence of economic reform have prevented the country from switching to alternative sources of finance and trade.

24. Viet Nam, also a member of the former CMEA, stands in sharp contrast to the experience of Cuba. Eastern Europe and the Soviet Union accounted for around 60 per cent of the country's exports and 70 per cent of its imports. But economic policy changes had already been shifting trade to convertible currency areas in the late 1980s. The country quickly became a major rice exporter, while the recent discovery of oil came as a boon. The changes in the East hastened the shift. Rice and oil exports are now the principal earners of hard currency. In 1992 exports to other Asian countries came to account for 80 per cent of the total exports, while imports from these countries rose to 75 per cent of the total imports. Among the countries adversely affected by the changes in the East, Viet Nam was perhaps the most successful in forging new trade links. It has been less successful in establishing new financial links. The country depended on Eastern Europe and the Soviet Union for the bulk of its external resources. The termination of external assistance from this source has not been followed by Western assistance, primarily because of the United States embargo, though, in particular, some Scandinavian donors and the Netherlands continued their assistance. By late 1992 several European countries resumed an economic relationship with the country. Also, Japan pledged a $375 million assistance package. Objections by the United States to multilateral lending to the country have recently been lifted.

25. Mongolia, the third developing country that was a CMEA member, had the closest economic link of all with the Soviet Union, which accounted for 90 per cent of the country's external trade. In 1990 exports of the country fell by over 40 per cent while imports contracted by 50 per cent. The sharp fall in economic assistance from the Soviet Union was reflected in a further fall of imports in 1991 to only 30 per cent of their 1989 level. In 1992 both imports and exports rose, and small shifts in trade away from Russia were becoming evident. In early 1992, the first significant multilateral assistance was pledged, primarily for balance-of-payments support and development of the mining sector.

26. In the group of "cooperant" countries, 5/ Afghanistan's link with the East, especially the Soviet Union, was among the closest. Over 60 per cent of the country's exports went to the Soviet Union, which supplied about 50 per cent of its imports. Immediately after the Soviet military withdrawal from Afghanistan, the country's bilateral trade plunged by at least 50 per cent. Soviet or Russian economic assistance has stopped. The political and military struggles have had devastating effects on the economy, overshadowing the consequences of the severance of ties with the former Soviet Union.

27. About 20 per cent of Ethiopia's imports originated in Eastern Europe and the Soviet Union, while about 10 per cent of the exports of the country went to that region. This trade is reported to have fallen substantially. 6/ Soviet

assistance, now almost stopped, was largely military. The change in the political regime in the country and efforts at economic reform have resulted in pledges of the first Western assistance in two decades and the United States has included the country in its Generalized System of Preferences (GSP).

28. In Nicaragua, which had developed close economic ties with the Soviet Union, the altered pattern of economic links has more to do with the change in the political regime in the country in 1989 than to changes in the East. In contrast to some of the other countries, the switch of the country to alternative sources of finance and trade was greatly facilitated by Western, particularly United States, initiatives. External assistance to the country increased sharply.

29. In the third group of countries - those with "close ties" with CMEA, India's trade with the Soviet Union and Eastern Europe was the largest and the economic ties between India and the Soviet Union among the closest. In 1989 about 18 per cent (about $2.7 billion) of India's exports and 10 per cent of imports were accounted for by the transition economies, of which the Soviet Union was by far the largest trading partner. The share in exports declined to around 10 per cent in 1992, while the import share fell to around 5 per cent. The disruption of trade with the Soviet Union contributed to the small decline in the country's trade in 1991. In recent months, however, there have been signs of more vigorous growth in India's exports, suggesting that the country may be beginning to overcome the effects of disruption of trade with the East. The trade with the former Soviet Union itself appeared to pick up in value terms in 1992.

30. While these cases already illustrate the contrasting experience of countries in the aftermath of the changes in the East, the contrast sharpens with the experience of some of the newly industrialized developing countries. Almost all of them continued to expand their trade with Eastern Europe and the successor States of the Soviet Union. Thus exports of the Republic of Korea to these economies increased four fold between 1989 and 1991. Exports of Hong Kong and Singapore also increased, albeit from a small base.

31. Exports of the major exporters of manufactures in Asia 7/ to the European Community rose by 50 per cent between 1989 and 1992. This increase may be particularly significant, because some of the Eastern European countries are aiming to increase their exports to that market and are in potential competition with the newly industrialized economies.

IV. EXTERNAL RESOURCES FOR TRANSITION

32. The sharp departure from past economic ideology and policy in Eastern Europe and the former Soviet Union called for a radical reallocation of national resources among economic sectors and activities. It also required additional resources. Replacement of an antiquated capital stock in many industries remains a priority while large new investments are needed in many others, which had been starved of funds under the old system, and in private enterprises. Much of the resource needs have to be met from domestic sources and are indeed being so met. Nevertheless, the need for external resources has proved large, especially because output and income shrank, leading to a sharp fall in domestic

savings. Stabilization policies, critical for the creation of conditions for sustained development, required external assistance. Economic distress and civil turmoil also called for humanitarian aid. The reduction of military expenditure that is taking place in these economies would free resources for long-term development but its impact during the transition period is mixed.

33. With a given amount of the world's financial resources, such additional demand would influence the direction of resource flows as well as the cost of these resources, that is, interest rates. The total financial resources available in the world economy are not, however, entirely fixed even in the short run, and the flow of resources to countries competing for them and the cost of finance are not all market determined.

34. Information on the flow of financial resources to the economies in transition is still patchy, and only broad orders of magnitude are available. The commitment of official international financial assistance to Eastern Europe and the successor States of the Soviet Union during the period 1990-1992 amounted to some $145 billion. 8/ In April 1993 the group of seven major industrialized countries pledged $43 billion to the Russian Federation, which included a debt rescheduling of $15 billion. There is probably some overlap between this package and the earlier $145 billion. Information of disbursement is even more scanty. There is little doubt, however, that it is a small fraction of the commitment.

35. Only a small proportion of the flow of resources to transition economies appears to have been accounted for by official development assistance (ODA) as conventionally defined. 9/ About $6 billion 10/ in ODA was provided by OECD countries to Eastern Europe and the successor States of the Soviet Union over the two years 1990-1991, or an average of $3 billion a year. A large proportion of this (almost 40 per cent in 1991) consisted of food grants and humanitarian assistance.

36. Private capital flows to these economies remain small. Medium- and long-term funds raised on international financial markets by these countries averaged around $4.7 billion during the period 1989-1990 but amounted to only $1.7 billion in 1991 and $1.5 billion in 1992. 11/ The flow of foreign direct investment rose from $0.6 billion in 1990 to $2.3 billion in 1991 and increased marginally to $2.8 billion in 1992. Low creditworthiness of many of these countries has held down the first type of private finance, while uncertain economic prospects have discouraged any large flow of the second. Moreover, these inflows of resources should be set against "capital flight" out of some of these economies, which is probably large, especially that out of the Russian Federation.

37. Resource flows to transition economies have been small compared with their world totals. The total annual flow of ODA from the members of the Development Assistance Committee (DAC) of the Organisation for Economic Cooperation and Development (OECD) to the far more numerous and generally much poorer developing countries amounted to around $56 billion during the period 1990-1992. The average volume of funds raised by the developing countries 12/ in international financial markets during the three years was about $9 billion, while the world total was around $360 billion. 13/ The gross flow of foreign direct investment

to the developing countries averaged $30 billion for the three years and the world flow amounted to over $150 billion. 14/

Implications for finance for development of developing countries

38. Given the high degree of globalization of the world financial markets, a large additional demand for financial resources originally expected from the transition economies could, other things remaining the same, raise the rate of interest world wide. This could seriously raise the cost of borrowing and debt serving for the developing countries. This fear, expressed at the inception of the changes, turned out to be unfounded. The relatively small effective flow of financial resources to the economies in transition had little impact on international interest rates. Although an indirect result of German unification has been that the European interest rates remained higher than they would have been without the event, international interest rates have fallen substantially. 15/ The recession and stagnation in the industrialized economies that coincided with the beginning of the transition process and the resulting expansionary monetary policies contributed to the fall.

39. For decades the centrally planned economies have provided substantial economic assistance to selected developing countries. The magnitude of the assistance has often been the subject of debate. As donors, these countries have claimed to have reached or surpassed the aid target of 0.7 per cent of GDP set in the Second United Nations Development Decade (E/1991/82, para. 102), while the OECD estimates put their aid disbursement at only 0.14 per cent of GDP in 1975 and at 0.23 per cent in 1985 (E/1991/82, para. 105). If, however, some of the non-conventional forms of resource transfer - such as imports from the developing countries being priced higher than world market prices or exports to them being subsidized - are taken into account, this would raise their real assistance above the average ODA/GNP ratio achieved by the industrial countries. An almost inevitable consequence of the transition in the East was a sharp decline in this volume of assistance. OECD data suggests the magnitude of the fall: total ODA of Eastern Europe and the Soviet Union fell from $3.0 billion in 1989 to around $1.0 billion in 1991 16/ and was probably negligible in 1992. The policy of greater use of world market prices by these countries, and hence elimination of subsidies on exports to developing countries and the element of assistance in the pricing of the imports from them, meant further sharp reductions in real assistance.

40. However, servicing of debt owed to Eastern Europe and the former Soviet Union has declined sharply. According to the World Debt Tables 1992-1993, debt owed to the former Soviet Union amounted to over $140 billion in 1991, the bulk of it owed by a dozen or so of developing countries. Debt servicing has declined sharply. In 1991 only about 25 per cent of debt service falling due was paid and payments in 1992 are reportedly even smaller. 17/

41. Much of the assistance, which was closely associated with trade links, was channelled to a few developing countries. In 1988, the three developing country CMEA members (Cuba, Mongolia and Viet Nam) accounted for 73 per cent of the total assistance from Eastern Europe and the Soviet Union (E/1991/82, para. 104). Although data for individual countries are not available, all three countries were seriously affected by the sharp fall in assistance because of their almost total dependence on aid from this source. Afghanistan, Angola,

Cambodia, Ethiopia and Mozambique also suffered a sharp reduction or an almost total cessation of assistance.

42. Apart from the decline of economic assistance from this source, concern has been expressed about the possible diversion of resources that would have flown to the developing countries in the absence of the changes in the East. The difficulties of assessing the counterfactual situation make it impossible to make a definitive statement about such diversion. A number of observations can nevertheless be made.

43. First, other things remaining the same, private resources flow where the expected rate of return on investment is the highest, taking into account the risks, both political and economic, of failure. On that account, developing countries have been able to attract far larger foreign private funds and private investments in recent years than the former centrally planned economies, and some within the former group have fared much better than others in this respect. In other words, private capital, the bulk of which originates in the industrialized countries, appears to be relatively less influenced by the historical and political considerations that affect the flow of public funds. As economic prospects in the transition economies brighten, however, and their move towards market-based decision-making becomes unequivocal, far larger amounts of financial resources could flow into these economies.

44. Second, the resource needs of the transition economies have greatly increased the demand for official external finance. In fact, in the absence of any significant flow of private finance, official finance constitutes the bulk of the flow of external financial resources to Eastern Europe and the successor States of the Soviet Union. There is thus an element of competition with developing countries for the relatively fixed amount of official resources. However, a distinction should be made here between concessional and non-concessional resources. Regarding non-concessional resources, the significant recent increase in the resources of both IMF and the World Bank, the principal multilateral lending agencies, gives more flexibility to accommodate the requirements of the transition economies.

45. Third, regarding concessional resources, the trend of the flow of official development assistance to developing countries from DAC countries appears to have remained unchanged in recent years. Total ODA from DAC countries increased from $45.7 billion in 1989 to $60.8 billion in 1992 in current exchange rates and prices. In volume terms, this amounts to an annual rate of growth of 2.7 per cent, which is about the same as the rate of growth during the 1980s. 18/ This does not of course mean that the trend could not change. Nor does this preclude the possibility of some diversion of economic assistance of individual donors from the developing countries. Industrial donor countries have, however, repeatedly committed not to allow such diversion.

46. Perhaps more important is the consideration that some of the former centrally planned economies are now beginning to have developing country status, increasing the number of ODA recipients. Thus some of the former Soviet republics in central Asia are now eligible for DAC assistance. 19/ Some of them are or may be eligible for IDA credit. With the total developed country ODA barely growing and IDA resources constant in real terms, an increase in the number of ODA recipients should imply a reduced availability of ODA per country.

47. The availability of sufficient official resources for developing countries depends in the ultimate analysis on the ability and willingness of the donor countries to provide such funds, both of which have been constrained in recent years. Slow economic growth, rising fiscal deficits and a certain amount of aid fatigue have combined to restrict the growth of ODA, even as most donor countries remain committed to make efforts to raise it (see also A/48/367).

V. IMPLICATIONS OF THE TRANSITION: SOME POLICY CONCLUSIONS

48. The issues of economic transformation in Eastern Europe and the former Soviet Union are essentially for these countries themselves to resolve. But the transition process can be facilitated, and its possible short-term adverse effects on other countries, and especially on the developing countries, can well be minimized in an atmosphere of robust growth in the world economy, in particular in the industrialized economies. The economies in transition need greater opportunities to trade with the rest of the world, as well as among themselves. The expansion of their trade can take place with less friction in export markets when world output and trade are growing reasonably fast. The need for increased external resources for the transition can be met without impinging on the needs of other countries only if the industrial economies are growing and generating sufficient resources.

49. An assessment of the long-term implications of the changes in Eastern Europe and the former Soviet Union is bound to remain speculative for the present. Uncertainties remain on the pace of the changes though the broad direction of the changes is clear enough. There is little doubt, however, that in the long term their impact will be highly positive for the growth of the world economy and the overwhelming majority of individual economies as well as for international cooperation.

50. While prospects for international cooperation have been brightened by the changes in the East, these changes have been accompanied by a perceptible shift in international attention from issues facing the developing countries. The possibility of a significant diversion of official external resources from developing countries in the next few years remains an open question; none the less, there is a keen feeling that the focus of attention of some of the major industrialized countries and multilateral development and financial institutions has shifted away from the developing countries. Improvement in international economic cooperation would seem to call for a more judicious distribution of international attention to the various emerging and old, yet unsolved, issues in the world economy.

51. One of the benefits of the change in East-West relations is the reduction of expenditure on armaments. The military expenditures of the United States and the Soviet Union made up 60 per cent of the global total and therefore a reduction in those expenditures will have the greatest impact on total expenditures. In the United States, military expenditure as a share of gross national product (GNP) is almost certain to go down from 6 per cent in the 1980s to 3 per cent in the 1990s. 20/ In the former Soviet Union arms production is thought to have declined by 50 per cent between 1990 and 1992. 20/ Not all the past reduction in arms expenditure should be traced to the easing of East-West tension and neither is the conversion of military facilities for civilian use

easy. Nevertheless, significant volumes of world resources are beginning to be released from uses that contributed little to economic well-being. There are indications that military expenditure in developing countries is also declining. The proliferation of local conflicts around the world that coincided with the changes in the East should not belittle the long-run benefits expected in the wake of these changes in East-West relations.

52. The substitution of market mechanism for central planning, while no panacea, should itself contribute to an improved allocation of resources among various national uses and thus increase efficiency. Duplication of efforts, production of goods that consumers did not want, and the lack of incentive to make the most efficient use of existing resources that had characterized much of central planning can be minimized when the price mechanism is allowed to work relatively freely. A judicious blend of price mechanism and deliberate policies should also promote environmentally sound use of resources and thus help to rectify some of the failure of environmental policies under central planning. Production and testing of weapons have contributed to environmental degradation. A reduction of military expenditure should contribute to the reversal of the process.

53. An increase in world economic well-being requires, however, that policies that hinder competition are phased out in other economies as well. Prescriptions for liberalization and competition given to the economies in transition need to be applied in other countries as well, including the industrialized economies. In both developing countries and transition economies growth will be facilitated by a further dismantling of the present barriers to trade. A successful conclusion of the Uruguay Round of multilateral trade negotiations would contribute to the smoothing of the transition process in the East, and, at the same time, raise the rate of growth of the developing countries.

54. As pointed out earlier, the transition in Eastern Europe and the former Soviet Union has tended to disrupt trade and financial links of a number of developing countries, but the overall impact on the latter countries as a whole has not been very substantial. In the longer run, the developing countries stand to benefit from the changes in the economies in transition. With the transition to the market economy completed, the production structure in Eastern Europe and the successor States of the Soviet Union would reflect their resource endowments and comparative advantage far more closely than before. This should help produce conditions favourable to the developing countries liberalizing their own production and trade structure to increase trade with the East. In third country markets, the recent experience of the more advanced developing countries suggests that the transition should not be an impediment to expanding trade flows. Obstacles to exports of developing countries to developed market economies appear at present to be the tariff and non-tariff barriers in the latter, rather than competition from the East.

55. Grounds for more legitimate concern could arise, however, for developing country exports on the question of preferential treatment given to the transition economies in the developed market economies. Improved access to the latter, especially Western Europe's market, is critical to the success of the transition in the East. The long-term objective of integration of these economies with those of Western Europe, of which the association agreements of

five of the Eastern European countries with the European Community is a first step, should be welcome. But such regional trading arrangements should not be discriminatory to the outsiders. A strengthening of the rules of the multilateral trading system, at a time when regional arrangements are becoming more common, is therefore a priority issue for the international community. 21/ Any preferences accorded to the economies in transition in the European Community should be seen in this broader context.

56. As the ranks of the developing countries swell with the inclusion of some of the low-income former centrally planned economies, it is critically important for the donor countries to look for ways to enlarge the size of the aid pie. The prospects for an increase in official development assistance are not promising. To be set against this is, however, the prospect that growth of many developing countries still dependent on official development assistance will suffer. Some of the traditional arguments for development assistance are being questioned and even a few - mostly of a political nature - may have ceased to be valid. In contrast, institutional and economic policy reforms in developing countries are being undertaken on an unprecedented scale. Many of these countries need official development assistance to speed up economic transformation and diversification while simultaneously protecting their people from the worst forms of deprivation. Growing investments and sustained efforts to eradicate poverty - part of which are unlikely to yield immediate results - do require international support. Increased ODA to developing countries and an expanding supply of medium- to long-term non-concessional official credit, bilateral and multilateral, should go pari passu with the growing supply of resources to economies in transition.

Notes

1/ See World Economic Survey 1992 (United Nations publication, Sales No. E.92.II.C.1), chap. I.

2/ Some of the trade data are subject to a large degree of uncertainty and should be seen only as broad orders of magnitude.

3/ Data do not permit a fully reliable assessment of the trend of exports in real terms.

4/ These figures are in United States dollar values. The changes in more recent months are difficult to assess due to data problems, but are likely to be considerably smaller.

5/ See footnote to table 2 for definition.

6/ IMF Direction of Trade data, however, show virtually no change in the value of exports to the former Soviet Union and an increase in the value of imports from the country. The latter may be due at least partly to higher prices charged on Russian oil exports.

7/ China, Hong Kong, India, Indonesia, Malaysia, Singapore and Thailand. Imports of the European Community from these countries rose from $46 billion in

1989 to $72 billion in 1992. (Source: IMF, Direction of Trade data on tape, July 1993).

8/ The period covered is from January 1990 and end-June 1992 for Eastern Europe and through November 1992 for the successor States of the Soviet Union. (Source: Economic Survey of Europe in 1992-1993 (United Nations publication, Sales No. E.93.II.E.1), p. 239, and table 4.1.3).

9/ Grants and concessional assistance with a grant element of 25 per cent or more.

10/ Excluding debt forgiveness. (Source: OECD, Aid and other resource flows to the central and eastern European countries and the new independent states of the former Soviet Union in 1991. Paris, 1993 (OECD/GD (93) 78)).

11/ Economic Survey of Europe in 1992-1993, tables 4.1.1 and 4.1.2.

12/ Capital-importing developing countries. (Source: World Economic Survey 1993, table A.27).

13/ Bank for International Settlements, 63rd Annual Report, Basle, 1993 (p. 90).

14/ Ibid., (p. 90).

15/ Thus, the London interbank offered rate (LIBOR) on six-month United States dollar deposits declined from over 9 per cent in 1989 to 3.9 per cent in 1992.

16/ OECD, Financial Resources for Developing Countries: 1992 and Recent Trends, Press Release (SG/PRESS (93) 41), June 1993.

17/ World Bank, World Debt Tables 1992-1993, vol. 1, p. 35. (For loans denominated in roubles, the old official exchange rate of less than one rouble per dollar was used.)

18/ DAC press release, 29 June 1993, and OECD, Development Cooperation, 1992 Report. The latter report (p. 89) gives a figure of 2.4 per cent for the period 1980/81-1990/91. The rate of growth in the second half of the 1980s declined to 1.6 per cent a year (DAC 1991 Report, p. 125).

19/ OECD includes, for example, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan in its list of developing countries with effect from 1 January 1993. See OECD Press Release, op. cit.

20/ Stockholm International Peace Research Institute (SIPRI), Yearbook 1992.

21/ On recent development of trade blocs, see World Economic Survey 1993 (United Nations publication, Sales No. E.93.II.C.1).